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SUBJECT: IRAQ: MINISTER OF FINANCE ON POLITICAL DYNAMICS, BRUSSELS CONFERENCE, JEC, AND SYRIA/LEBANON ASSET RECOVERY

REF: STATE 106124

Classified By: Deputy Chief of Mission David M. Satterfield for reasons 1.4 (b) and (d)

1. (S) SUMMARY: Describing his take on current maneuvering within the Iraqi Transitional Government (ITG), Finance Minister Allawi told the DCM June 8 he does not think Prime Minister Ja'afari has done a good job in articulating a clear political position and is having difficulty managing the government. Allawi, who referred to himself and Planning Minister Saleh as "cat's paws" in a larger political game between Shia and Kurdish political figures, said he hopes a final decision on where responsibility for donor coordination will fall will be made within a few days. In any event, Allawi stressed he and Saleh will work closely together to make a successful Iraqi showing at the Brussels Conference. In reply to the DCM's delivery of reftel talking points on the importance of substantive reform deliverables for Brussels and the JEC, Allawi noted he has already pitched a strategy for reductions in food and fuel subsidies to the Council of Ministers. MoF will try to re-engage with Syria on return of frozen assets and provide Embassy with a detailed read out of the problems it is encountering in recovering the \$140 million in assets that remain frozen in Lebanese commercial banks. END SUMMARY.

BOSNIAN SOLUTION

2. (S) During a frank and open discussion with the DCM on June 8, also attended by Treasury Attache and econoff, Minister of Finance Allawi shared his thoughts on the current state of debate within the ITG as to Iraq's political future. While stressing it is too early to make definitive judgments as to what can be constituted a trend, Allawi observed, it is possible that Iraq may be headed, whether by design or not, towards some kind of "Bosnian solution." Sunni Arabs are not yet fully adjusted to their loss of status, but appear resigned to the existence of a Kurdish Federation. Few Kurds view Iraq as a natural, long-term entity, but are prepared to give short-term support to the political process as long as their principal interests and conditions are met. The Shias, for their part, are prepared to concede much to get a resolution to political stalemate, but will not go so far as to accept an inequitable "Muslim-Croat" form of power division.

3. (S) Allawi said he would only give the performance of the ITG a C minus rating. Noting in the Prime Minister's defense that he has only been in power for a few weeks, Allawi stressed that Ja'afari has nevertheless failed thus far to articulate a clear political position and vision. He commented that Ja'afari is overloaded with trying to achieve too many goals, rather than focus on a few that are doable, a similar trap that the Iraqi Interim Government (IIG) fell victim to. The ITG also suffers from over-centralization of decision-making authority within the Prime Minister's office and micro-management of even relatively minor administrative issues.

POLITICAL CAT'S PAWS

4. (S) Noting that Ja'afari still has many issues to work out with the Kurds, Allawi said Shias are divided in terms of how they see relations with the Kurds developing. One view, represented by Supreme Council of the Islamic Revolution in Iraq (SCIRI) leader Abdul Aziz Hakim, is that the Kurds should be developed as long-term allies. Others, however, do not want to see the ITG made hostage to Kurdish demands. Vice President and SCIRI member Adel Mahdi is very close to the Kurds. Mahdi's candidacy to head the ITG was withdrawn, Allawi continued, when SCIRI decided it would be best not to have to take responsibility for a short-term government. Dawa leader Ja'afari, on the other hand, was persistent in his pursuit of the position and it became clear that there would be no viable alternative to Ja'afari.

5. (S) Referring to himself and Planning Minister Saleh as "cat's paws" in a larger political game, of which the struggle over which ministry is to control the donor assistance portfolio is just a small reflection, Allawi said

he thinks there is a better than even chance (60/40) the issue will be resolved within two days. According to Allawi, Ja'afari is likely to "capitulate" to the Kurds and allow the function to remain with Saleh as he will be unwilling to risk the success of his government over the issue. Allawi characterized Ja'afari's political style as one that always leaves room for maneuvering, something that is sometimes misinterpreted as being indecisive. In fact, Ja'afari enjoys and is good at high stakes political poker. With regard to PM spokesmen Laith Kubba, who has been less than careful in a number of public statements (e.g., charges against Saddam and Iraqi debt write-off), Allawi speculated that Ja'afari may have had some unknown, byzantine reason for giving Kubba the position. He added that Kubba is not trusted at all by the Kurds.

16. (C) As he has "no ego involved" in the outcome, Allawi stressed that, if a political resolution of the donor coordination debate within the ITG is not achieved soon, he will work out a mutually agreeable arrangement directly with Saleh with whom he personally gets along very well. The DCM interjected it is critical that Allawi and Saleh be united and be prepared to present a strong message of the ITG's commitment to economic reforms. To lose the opportunity Brussels represents to line up international support would be a major setback for the ITG. The United States will do everything possible to make the conference a major success, but in the end it will be up to Iraq. The DCM added that the ITG Ministers of Defense and Interior have committed to work together closely. Acknowledging the DCM's comments, Allawi remarked an agreement to coordinate efforts for the Brussels Conference had been reached by the relevant ministers during a meeting earlier in the day at the Ministry of Foreign Affairs.

17. (C) With regard to division of responsibility on donor coordination issues, Allawi said a "technical solution" would be to spin off to MoF the capital budget function of the Ministry of Planning and Donor Coordination (MoPDC) and establish donor coordination as a new unit under the Prime Minister's office to be headed by Saleh. Such a solution would help Ja'afari to save face since he has already announced publicly that donor coordination would go to MoF. The new unit would be responsible for accelerating the flow of aid and project implementation. Allawi said that Saleh himself favors dismantling the MoPDC. Its remaining functions could serve to perform data collection and statistical analysis.

PREPARING FOR THE JEC

18. (C) Transitioning to the topic of the upcoming Joint Economic Commission to be held in Amman in July, the DCM delivered reftel talking points (a copy of which was left with Allawi as a non-paper). He stressed the high-level composition of the US delegation and noted the success of Iraqi participation will be judged by how much progress on economic reform can be announced. Allawi, the DCM reiterated, should come prepared to announce subsidy cuts in Brussels, in preparation for the JEC. At a minimum, it is imperative Iraq's intent to proceed with specific cuts be declared.

19. (C) In response, Allawi noted he has already been doing the groundwork for cuts in food and fuel subsidies and discussed his thinking at a recent meeting of the Council of Ministers. While there is consensus within the ITG that reform of Iraq's system of subsidies is critical, some in the government are wary about the lack of a sufficient social safety net and any raise in fuel prices at a time of political stress. Many Iraqis already pay higher prices for gasoline on the black market, but many others still wait in line to get it for free. Allawi believes he will be able to achieve political agreement to proceed with phased-in increases in the price of gasoline, leading to a 20 percent cut in expenditures in fuel subsidies, a measure that should satisfy the IMF Iraq is being faithful to its Emergency Post Conflict Arrangement (EPCA) commitments.

10. (C) As to cutting the cost of the Public Distribution System, Allawi said he favors eliminating some of the items currently handed out and focusing the system on key commodities only, thereby saving up to \$500 million. Allawi agreed with the DCM that from a budgetary standpoint, there is little wriggle room for Iraq to meet large security expenditure needs except through subsidy cuts. Allawi also concurred on the importance of close budget coordination with the Ministries of Defense and Interior and the need to protect pipeline infrastructure so that oil revenues are not lost.

ASSET RECOVERY: SYRIA

11. (C) Reviewing with the DCM the status of Iraq's asset recovery discussions with Syria and Lebanon, Allawi confirmed nothing substantive has taken place since the return of an Iraqi technical team in mid-April. Out of an almost \$2 billion in total Iraqi frozen assets abroad, Syria holds the largest single share at \$262 million. (Note: although a specific amount was not given, Allawi also noted Bahrain for its holdings of Iraqi assets. End note). Despite requests in writing from Iraq to do so, Syria has refused to transfer any of the funds from the Commercial Bank of Syria or the \$71 million sitting in its Lebanese subsidiary, the Syrian-Lebanese Commercial Bank.

12. (C) Allawi said he was thinking of advising Prime Minister Ja'afari to try to solve the issue personally in Syria, but concurred with the DCM's recommendation that it would make more sense for Iraq to send a technical team. The Syrians are extremely isolated diplomatically and would likely try to turn a Ja'afari visit to their political advantage. Iraq should hold Syria's feet to the fire and insist upon agreement of asset transfer and an actual significant flow of funds before any high-level visits to Damascus are considered. Especially in light of Syria's looming June 15 deadline to achieve progress on this and other issues or face potential Section 311 sanctions, the DCM continued, now is a perfect time for Iraq to press for resolution of the issue. Allawi agreed and noted the DCM's comments came at a timely moment.

ASSET RECOVERY: LEBANON

13. (C) Allawi said Lebanese banks still hold approximately \$140 million out of what had once been \$300 million in Iraqi frozen assets. He asserted it is not true that Iraq has not contacted the Lebanese Central Bank Governor about the assets. The difficulty in getting the assets back appears to be that the Lebanese banks (e.g., Mourad and First Bank of Lebanon) that hold the Iraqi ministerial accounts do not operate according to strictly international standards and appear to be trying to bargain over transfer terms. The DCM volunteered the USG is willing to assist, but it would be necessary to have specific information on a bank-by-bank basis as to the problems Iraq is running into in Lebanon. The USG has been receiving very conflicting information over whether the ITG had or had not requested transfer of funds in Lebanese commercial banks. Allawi agreed that there was internal ITG confusion on the issue which needs to be resolved and indicated he would try to work with the Central Bank and get us visibility on DFI account information to analyze possible transfers into it of frozen assets.

14. (C) COMMENT: Embassy will follow up soonest with the head of MoF's asset recovery team to determine what specific steps the Ministry intends to take next week on recovery of Iraqi assets from Syria. Embassy will also engage the Central Bank directly. END COMMENT.

15. (U) REO Hillah, REO Basra, REO Kirkuk, and REO Mosul minimize considered.
Jeffrey